Supreme Court, U.S.
FILED
JUN 5 1992
OFFICE OF THE CLERK

No. 91-1135

IN THE

Supreme Court of the United States

OCTOBER TERM, 1991

NEWARK MORNING LEDGER CO.,

Petitioner,

v.

UNITED STATES OF AMERICA,

Respondent.

On Writ Of Certiorari To The United States Court of Appeals For the Third Circuit

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BRIEF OF AMICI CURIAE THE NEW ENGLAND FUEL INSTITUTE, THE EMPIRE STATE PETROLEUM ASSOCIATION, THE FUEL MERCHANTS ASSOCIATION OF NEW JERSEY, AND THE OREGON PETROLEUM MARKETERS ASSOCIATION IN SUPPORT OF PETITIONER

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June 5, 1992

PRESS OF BYRON S. ADAMS, WASHINGTON, D.C. (202) 347-8203

TABLE OF CONTENTS

	Page
INTEREST OF THE AMICI CURIAE	1
SUMMARY OF ARGUMENT	4
ARGUMENT	7
I. THERE IS NO LEGAL BASIS ON WHICH TO DENY A DEPRECIATION DEDUCTION FOR INTANGIBLE ASSETS THAT WASTE	7
A. The Internal Revenue Code Provides a Single Requirement for the Depreciation of an Identifiable Intangible Asset—That It Have a Wasting Life—Which Was Satisfied Here	7
B. The Test Adopted by the Third Circuit Conflicts with the Statute and the Regulation, Creates Confusion In the Law, and Should be Rejected	8
C. Examples Illustrate How Wasting Customer Relationships Have A Value Distinct From Goodwill	12
D. Whether Customer Relationships Are Sold With Or Without a Going Concern Is Irrelevant	15
E. Any Distinction Between Fixed-Term Contracts and Contracts Terminable-At-Will Is Unsustainable	17
II. CUSTOMER BASES IN THE HEATING OIL INDUSTRY ARE SEPARATELY VALUED USING THREE ACCEPTED METHODS	20
A. There Is No Single Appropriate Method of Valuation	20
B. An Appraiser Must Value the Correct Asset, Which Was Not Done Here By the IRS	21

C. In the Heating Oil Industry, All Three Methods Are Available to Value the Customer Base Separately 22

CONCLUSION 24

TABLE OF AUTHORITIES

CASES Page

885 Investment Co. v. Commissioner, 95 T.C. 156 (1990) 20

ABCO Oil Corp. v. Commissioner, 90 T.C.M. (P-H) ¶ 90,040 (1990) 2,4

Anderson v. City of Bessemer City, 470 U.S. 564 (1985) 21

Anselmo v. Commissioner, 80 T.C. 872 (1983), *aff'd*, 757 F.2d 1208 (11th Cir. 1985) 22

Business Service Industries, Inc. v. Commissioner, 55 T.C.M. (P-H) ¶ 86,086 (1986) 19

Clarke v. Haberle Crystal Springs Brewing Co., 280 U.S. 384 (1930) 11

Cohan v. Commissioner, 39 F.2d 540 (2d Cir. 1930) 15

Commissioner v. McCann, 146 F.2d 385 (2d Cir. 1944) 20,21

Delaware, Lackawanna & W. R.R. v. Pennsylvania, 198 U.S. 341 (1905) 20

Elmhurst Cemetery Co. v. Commissioner, 300 U.S. 37 (1937) 20

Guggenheim v. Rasquin, 312 U.S. 254 (1941) 21

Holden Fuel Oil Co. v. Commissioner, 479 F.2d 613 (6th Cir. 1973) 2

Jacobson v. Commissioner, 58 T.C.M. (P-H) ¶ 89,606, (1989) 22

Kimball Laundry Co. v. United States, 338 U.S. 1 (1949) 21

Los Angeles Gas & Elec. Corp. v. Railroad Comm'n, 289 U.S. 287 (1933) 21

Massey Motors Inc. v. United States, 364 U.S. 92 (1960) 15

Table of Authorities Continued

	Page
National Muffler Dealers Ass'n v. United States, 440 U.S. 472 (1979)	10
Palmer v. Connecticut Ry. & Lighting Co., 311 U.S. 544 (1941)	21
Powers v. Commissioner, 312 U.S. 259 (1941)	21
Procacci v. Commissioner, 94 T.C. 397 (1990)	21
Richard S. Miller & Sons, Inc., v. United States, 537 F.2d 446 (Ct. Cl. 1976)	10
Sandvik, Inc. v. Commissioner, 55 T.C.M. (P.H.) ¶ 86,588 (1986)	19
Western Union Tel. Co. v. Taggart, 163 U.S. 1 (1896)	20
Williams v. McGowan, 152 F.2d 570 (2d Cir. 1945)	11

STATUTES AND REGULATIONS

26 U.S.C. § 167(a) (1988)	4,7,8
26 U.S.C. § 338 (1988)	11
26 U.S.C. § 1060(a) (1991)	10
26 C.F.R. § 1.167(a)-1(b) (1990)	6,19
26 C.F.R. § 1.167(a)-3 (1990)	5,9,18
26 C.F.R. § 1.170A-1(c)(2) (1990)	20
26 C.F.R. § 1.10601T-(a)(1),(d)(iii) (1990)	11
26 C.F.R. § 1.338(b)-2T(d)(xiii) (1990)	11
Rev. Rul. 59-60, 1959-1 C.B. 237	20
T.B.R. 44, 1 C.B. 133 (1919)	9

MISCELLANEOUS

Note, *Amortization of Intangibles: An Examination of the Tax Treatment of Purchased Goodwill*, 81 Harv. L. Rev. 859 (1968)	10,11

Table of Authorities Continued

	Page
Webster's Third New International Dictionary (1976)	11
Gregorich, *Amortization of Intangibles: A Reassessment of the Tax Treatment of Purchased Goodwill*, 28 Tax Lawyer 251 (1975)	11
S. Rep. No. 313, 99th Cong., 2d Sess. 252 (1986)	21

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INTEREST OF THE AMICI CURIAE

The New England Fuel Institute ("NEFI"), the Empire State Petroleum Association ("ESPA"), the Fuel Merchants Association of New Jersey ("FMA"), and the Oregon Petroleum Marketers Association represent more than 2500 companies that comprise about 75 percent of the United States retail heating oil

industry. Virtually all of these companies are privately held and independent of any oil producer or refiner. Most are family owned, many in their second or third generation of family management. They primarily market heating oil to residential and commercial end users.

The retail heating oil industry is highly fragmented. Many small companies were established in the 1940's and 1950's by sole proprietors who are now reaching retirement age. As a result, there is considerable consolidation in the industry. These companies' assets are largely intangible, the most valuable of which are indefinite term contracts with existing customers to sell heating oil pursuant to "automatic delivery" arrangements. In recent years, hundreds of heating oil companies have been valued and purchased in reliance upon decided cases allowing amortization of these contractual customer relationships over their useful lives.[1] The government acquiesced in this practice in all of the audited transactions of which we are aware.

Pursuant to an automatic delivery contractual relationship, oil is delivered, based on historic consumption patterns and weather conditions, until the customer exercises a "negative option" to terminate. Based on historical use patterns, each customer's anticipated purchases can be calculated with considerable accuracy and certainty,[2] as can the anticipated

[1] *See Holden Fuel Oil Co. v. Commissioner*, 479 F.2d 613 (6th Cir. 1973); *ABCO Oil Corp. v. Commissioner*, 90 T.C.M. ¶ 90,040 (1990).

[2] A full-service heating oil dealer may also have a number of non-contractual or "will call" customers. Their gallonage is less predictable and is not included in the calculation of value related to the customer base.

decline in the number of customer relationships. Typically, the useful life of a customer base is seven to ten years.

Acquisitions in the heating oil industry always include the transfer of the seller's principal asset—the right to deliver heating oil to existing customers until the contracts are cancelled. The purchase of customer relationships may be with or without a transfer of name, employees or management. The purchaser ordinarily obtains not only names, addresses, and information concerning the customers' heating systems and fuel use patterns, but also the assignment of the contractual right to deliver oil until the agreement is terminated. More than 75 percent of the value of a fuel oil business is its customer relationships, sold with or without the company name and management.

A retail heating oil dealer has virtually no "goodwill" as understood in the lay sense. There are no product brand names. Competing dealers sell the identical product.[3] Sales are not made from any retail sales outlet. Thus, there are no preferred brand names or locations, as there are in most retail sectors; and sales are made either at the customer's home or by telephone. There are extremely low barriers to entry, the requirements being only a fuel oil delivery truck and enough working capital or credit to acquire inventory. There are hundreds of competitors in many markets.

For two decades and in scores of transactions, the IRS has approved the amortization of the value of an acquired heating oil customer base separately from

[3] Heating oil is not generally sold using the brand name of a major oil company supplier.

"goodwill." Where substantially all of the assets of a seller are transferred, the IRS has insisted that a portion of the purchase price be allocated to goodwill (usually from 5 to 25 percent of the total intangibles), but has concurrently approved deductions to amortize a separate, wasting customer base as described above.[4] This IRS practice has been relied on in numerous transactions and in financings therefor.

The amici curiae are concerned that the *per se* rule of law announced by the Third Circuit could be applied to the heating oil industry, with unjustified, inequitable and serious adverse economic impact on the small businesses comprising the industry. It would remove the financial underpinnings of prior transactions in which customer relationships are currently being amortized, even though prior deductions related to these very transactions have been approved in prior audits. In short, it would substantially reduce the value of these businesses and undermine their financial integrity.

SUMMARY OF ARGUMENT

The court of appeals' *per se* test, denying amortization of all customer-based intangibles when purchased with a going concern, directly conflicts with Internal Revenue Code Section 167(a) and grossly distorts the intent of the regulations issued thereunder, which both require a depreciation allowance for wasting assets. The court of appeals would have a trier

[4] The IRS challenged the deductions taken by one heating oil dealer, but did not appeal its loss in the Tax Court, which held that the customer relationships had limited useful lives, had a value separate from goodwill and thus were depreciable. *ABCO Oil, supra* note 1, at 193-94.

of fact ignore, contrary to the Code, evidence that acquired customer relationships have ascertainable, declining value, on the basis that the taxpayer had not met the additional requirement that it prove the asset has no attribute of "goodwill," as used in the lay sense. Such a test would impose an amorphous standard not contemplated by the Code, producing inappropriate results and upsetting the basis of numerous completed and proposed transactions.

The proposed rule—prohibiting amortization of wasting customer relationships if sold together with any element of "goodwill"—produces incongruous results. A wasting asset that can be sold or reproduced separately, and hence which is deductible, would lose its separate value and deductibility when it is sold as part of a going concern. According to the court of appeals, any asset, even those that are plainly amortizable, if interrelated with goodwill would become non-amortizable. A patent or copyright, for example, that is intermingled with "goodwill" would not be amortizable, in conflict with IRS rules regarding their amortization. A separately valued customer relationship is no different from a patent or copyright in this regard. Some factual circumstances may, by their nature, increase the taxpayer's evidentiary responsibilities to prove the separate value of customer relations, but if a value for this wasting asset is demonstrated, a deduction must be allowed.

Further, the Government's attempt to distinguish between fixed-term and terminable contracts conflicts with the Service's own regulations, which permit "experience or other factors," 26 C.F.R. §1.167(a)-3, to guide a determination of useful life, and which specifically reject utilizing the "useful life inherent in the

asset" in favor of "the period over which the asset may reasonably be expected to be useful . . . ." 26 C.F.R. §1.167(a)-1(b). The distinction ignores the real-world value placed by purchasers on other contractual relationships, based on business experience.

The experience of the heating oil industry illustrates the unreasonableness of the Third Circuit's *per se* rule and its incompatibility with market reality. Like newspaper subscribers, heating oil customers have requirements contracts without explicitly fixed duration (although the "negative option" may be more specific). Also like newspaper subscribers, heating oil customers move, die, change suppliers over periods that can be ascertained and established, with even greater certainty than many tangible assets. Distinctively, however, heating oil customer relationships are sold regularly in every major market, with and without the name, management, or employees of the seller. Also unlike newspapers, heating oil companies have virtually no "goodwill" as commonly understood. Heating oil is a commodity, and thus the product is brandless and fungible, and the principal distinguishing factor is price, which means that the name and reputation of a heating oil company does not have substantial value. Yet, despite this lack of traditional "goodwill," the Third Circuit's rule would anomalously define most of a heating oil company's asset base as goodwill.

Further, the heating oil industry offers everyday examples of customer relationships that are valued by several methods—income, comparable sales, and replacement cost—in transactions that involve little or no "goodwill." This practice of valuing customer relationships separately from "goodwill" has been accepted by the IRS, and is in direct conflict with the new *per se* rule announced by the court of appeals.

The prevailing fact-based standard for determining whether an asset has a limited useful life and a separate value is the only test that can address the wide variety of assets and industries in which this subject arises. If a simpler rule is sought, Congress must modify this provision of the Code, which has been left unchanged for 75 years.

ARGUMENT

I. THERE IS NO LEGAL BASIS ON WHICH TO DENY A DEPRECIATION DEDUCTION FOR INTANGIBLE ASSETS THAT WASTE

A. The Internal Revenue Code Provides a Single Requirement for the Depreciation of an Identifiable Intangible Asset—That It Have a Wasting Life—Which Was Satisfied Here

Under Section 167(a) of the Code, all that is required to sustain a deduction is that an identifiable business asset have a measurable and ascertainable useful life, *viz*: "There *shall* be allowed as a depreciation deduction a reasonable allowance for the exhaustion, wear and tear . . . " of property used in a trade or business. 26 U.S.C. § 167(a) (1988) (emphasis added).

Applying the statute, the district court made two critical factual findings: first, that Morning Ledger's customer relationships wasted due to "death, relocation, lack of reader time or interest, changing lifestyles . . . dissatisfaction with the product or service and for various other reasons, including competition from other media sources, such as radio, television, magazines and other . . . newspapers" (Pet. App. 40a);

and second, that the relationships "were not self-regenerating, i.e., there is no automatic replacement for a subscriber who terminates his or her subscription." *Id.* The Government "did not contest" critical evidence; indeed it "stipulated to Morning Ledger's estimates of the useful lives of the subscription relationships." Pet. App. 6a.

On appeal, the Third Circuit acknowledged that a determination as to useful life is "generally a factual question" (Pet. App. 8a), and it did not disturb the district judge's factual findings as to useful life. *Id.* at 29a.[5] Instead, it asserted that "notwithstanding" that the customer relationships "have wasting lives," they are "nonetheless goodwill and nondepreciable." (Pet. App. 29a).

This conclusion is irreconcilable with Section 167(a), because identifiable assets that waste over a limited period are *per se* depreciable; and characterizing them as "goodwill," which does not have an ascertainable limited life, is not merely contradictory, but irrelevant. The court made no attempt to reconcile its holding with Section 167(a). On this facial conflict alone, the decision below should be reversed.

B. The Test Adopted by the Third Circuit Conflicts with the Statute and the Regulation, Creates Confusion in the Law, and Should be Rejected

The Third Circuit's holding also conflicts with the IRS interpretive regulation, which properly provides that wasting intangibles are depreciable. The regulation allows depreciation for any "intangible asset

[5] The only factual finding overturned related to whether the subscriber list was "separate and distinct from goodwill." Pet. App. 30a.

. . . of use in the business or in the production of income for only a limited period, the length of which can be estimated with reasonable accuracy . . . ." 26 C.F.R. § 1.167(a)-3 (1990). Patents and copyrights are specific examples. *Id.* Conversely, "[a]n intangible asset, the useful life of which is not limited, is not subject to the allowance for depreciation." *Id.* "Goodwill" is set forth expressly as an example of an asset for which "[n]o deduction for depreciation is allowable." *Id.*

The IRS described its "controlling rule," in Regulations adopted initially in 1918, as follows: "Intangibles, the use of which in the trade or business is definitely limited in duration, may be the subject of a depreciation allowance." T.B.R. 44, 1 C.B. 133, 134-35 (1919). The corollary, that goodwill is nondepreciable, follows because "goodwill has an indeterminate useful life." Brief of the United States at 28, No. 90-5637 (3d Cir.). The essence of this distinction is established by a facts-and-circumstances analysis of whether an identifiable asset has a limited useful life. This rule has not changed in almost 75 years.

The Third Circuit's application of the IRS regulation is demonstrably erroneous because it ignores the very criterion established by the Code—whether the asset exhausts—and thus the court ignored evidence showing the *limited duration* of purchased customer relationships due to their predictable and measurable *exhaustion*. The court found, in direct conflict with the statute,[6] that "there are some intangible assets

[6] The IRS's regulation is consistent with the statute to the extent that its characterization of "goodwill" as nondepreciable is read as an example of a nonwasting asset. To the extent it

which, *notwithstanding that they have wasting lives* that can be estimated with reasonable accuracy and ascertainable values, are nonetheless goodwill and nondepreciable." App. 29a (emphasis added).

The Third Circuit based this holding on a definition of "goodwill" (the "expectation of continued patronage") not present in the Code or the regulations and that is, at best, one definition among many.[7] Even if defining goodwill were relevant to the determination of deductibility, there is no evidence that Congress envisioned any such definition when it enacted Section 167 or any related law.[8] Further, the IRS has not so

sets up "goodwill" as an independent concept that embraces wasting assets, it is in conflict with the Code. To the extent there is ambiguity, the IRS regulation should be construed to harmonize with the language of the governing statute. *National Muffler Dealers Ass'n v. United States*, 440 U.S. 472, 477 (1979).

[7] Goodwill has been defined in various ways. As characterized by the court of appeals, it is the expectancy that the old customers will resort to the old place. Pet. App. 10a-11a. In economic terms, goodwill may be viewed as the excess over the rate of return on tangibles and intangibles customary in an industry, Note, *Amortization of Intangibles: An Examination of the Tax Treatment of Purchased Goodwill*, 81 Harv. L. Rev. 859, 861 (1968), but it has also been defined as the normal rate of return on intangibles only. *Richard S. Miller & Sons Inc. v. United States*, 537 F.2d 446, 451 (Ct. Cl. 1976). In accounting terms, goodwill is an intangible asset comprising "the cost of an acquired enterprise over the sum of identifiable net assets." ASCT §§ 160.101, 160.401; APB Op. No. 17 ¶ 1.

[8] The only definition of "goodwill" adopted by the Congress is a "residual" one—*i.e.*, the value that remains after all separately identifiable tangible and intangible assets are valued. In an asset acquisition, if the purchaser and seller agree in writing as to the allocation of consideration, they must use the residual method for valuation of goodwill. 26 U.S.C. § 1060(a) (1991); 26 C.F.R. § 1.10601T-(a)(1),(d)(iii) (1990); 26 U.S.C. § 338 (1988); 26 C.F.R. § 1.338(b)-2T(d)(xiii) (1988). The residual method was employed by Morning Ledger. Pet. App. 37a.

defined goodwill in its regulations. Pet. App. 10a n.5. Finally, the definition does not even comport with standard usage, *see Webster's Third New International Dictionary* at 979 (1976), or with economic principles or accounting practices.[9]

In fact, no independent definition of "goodwill" is necessary to apply this regulation because goodwill for this purpose must be, under the Code, those assets which have no ascertainable limited useful life. The purchased subscriber base here clearly is not "goodwill" because it is not self-regenerative (Pet. App. 40a-41a) and has a limited and ascertainable useful life. (Pet. App. 40a).[10] The customer relationships are distinct assets of the seller, and were valued as such by the purchaser, and these relationships will exhaust themselves over a reasonably predictably period, just as will trucks or other tangible assets purchased. The

[9] *See, supra*, n.7.

[10] The assumption that goodwill has an unlimited life has been questioned. Even after *Clarke v. Haberle Crystal Springs Brewing Co.*, 280 U.S. 384 (1930), Judge Hand adhered to the view that goodwill is depreciable. *Williams v. McGowan*, 152 F.2d 570, 572 (2d Cir. 1945). *See also* Gregorich, *Amortization of Intangibles: A Reassessment of the Tax Treatment of Purchased Goodwill*, 28 Tax Lawyer 251, 274 (1975); Note, *supra* note 7, 81 Harv. L. Rev. at 863. The notion is that the "excess profits" produced by goodwill *will* waste unless management continually invests in product quality, customer service, and other profit-producing areas. For example, it is apparent that the "goodwill" of certain domestic automobile manufacturers has wasted to some degree over the past twenty years, although possibly in an unpredictable manner.

district court so found, and the court of appeals did not disturb that determination.

C. Examples Illustrate How Wasting Customer Relationships Have A Value Distinct From "Goodwill"

The Third Circuit's decision rests principally on its view that when a customer base is "acquired in conjunction with the sale of the underlying business as a going concern . . . it is simply often too difficult . . . to separate the value of the list *qua* list from the goodwill value of the customer relationships/structure." Pet. App. 29a. However, wasting customer relationships and goodwill are regularly identified and valued separately by prospective purchasers. That a transaction may transfer *both* assets at the same time does not mean that the two merge, lose their separate identities, and cannot be valued separately. To the extent these assets are valued separately by purchasers, sellers, bankers,[11] economists and financial appraisers, there is no reason why they cannot be valued separately by the taxpayer and the court. The following examples may serve to illustrate this point:

1. A prospective purchaser (or lender to the purchaser) of the Baltimore Orioles sports franchise would value the income from season ticket holders separately from customers who purchase tickets on isolated occasions. The season ticket holders buy in season "lots," are identified, have a measurable duration of patronage and thereby present relatively predictable patronage and income, the present value of which is ascertainable. Patrons that buy only isolated games are not readily identifiable, and have ticket purchasing habits that are uncertain. Their value or their duration is more speculative. For these reasons, season ticket holder relationships have a separate (and obviously greater) value than those involving per-game sales.

If it were shown that the base of season ticket holders wasted in a readily predictable manner and had an ascertainable value, a deduction would be required under the statute. By contrast, the value of the expected single game purchases would present a very different set of evidentiary hurdles and would likely be accounted for as goodwill. The fact that the two assets are sold together does not mean that the first is not amortizable.

2. Turning to the heating oil industry, assume, for example, that Company A has 200 customers under contract to deliver their heating oil requirements automatically until the customer exercises an option to cancel (a "negative option contract"). Company B also sells heating oil to 200 customers, but only 100 have negative option contracts, while the other 100 are "will call" customers that are served only if they place an order. Company A will command a higher purchase price in the market. Company A's 200 customer relationships have ascertainable value and a determinable useful life (as will the lesser number of negative option contract customers of Company B). Under Section 167(a), depending on the taxpayer's evidence, these customer relationships will be depreciable. By contrast, B's "will call" homeowners are not likely to have a determinable and reasonably ascertainable useful life, and hence are likely to be nondepreciable.

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[11] For example, bankers will accept a lien on a heating oil dealer's customer relationships, but not on its goodwill value.

3. Similarly, newspapers have both paid subscribers and newsstand purchasers. Say, for example, that A has 90 paid subscribers and averages 10 newsstand purchasers. B has only 50 paid subscribers and averages 50 newsstand purchasers. "A" will command a higher price, due to the higher and separate value, certainty and determinability provided by its paid subscribers. While the newsstand purchasers also have value, their level of purchases and useful lives likely are not reasonably determinable, and thus are of lower value and are apt to be nondepreciable. That *both* are transferred in the same transaction does not negate their separate characteristics.

4. Any perceived "difficulty" (Pet. App. 29a) in separating the value of depreciable customer relationships from "goodwill" is not a basis for denying depreciation where the taxpayer has met its burden of proving value and useful life for the identifiable asset. For example, a patent or copyright may be a principal asset of an enterprise, as in the case of a developer of computer software. The patent for a successful computer program may give the company an advantage over its rivals, enhancing its name recognition and reputation (customarily viewed as components of its "goodwill"). However, even though there may be a relationship between the value of the patent and "goodwill," a depreciation allowance is specifically provided for by regulation, 26 C.F.R. § 1.167(a)-3, because a patent has a limited useful life. The commercial value of the patent, established by evidence, lays the basis for a depreciation allowance, which is permitted.

Thus, even where the value of one asset, such as customer contracts, has some relationship to goodwill,

the asset does not, *ipso facto*, become goodwill or lose its establishable value and depreciability. Rather, the interrelationship simply requires that there be a proper valuation of each asset. The need for valuation, while perhaps not simple or exact, cannot, under the statute, be a basis for denying the deduction entirely, so long as it is reasonable. As Judge Learned Hand commented regarding the difficulty in establishing deductible business expenses:

> Absolute certainty in such matters is usually impossible and is not necessary; the Board should make as close an approximation as it can, bearing heavily if it chooses upon the taxpayer whose inexactitude is of his own making. But to allow nothing at all appears to us inconsistent with saying something was spent. . . . It is not fatal that the result will inevitably be speculative; many important decisions must be such.

Cohan v. Commissioner of Internal Revenue, 39 F.2d 540, 543-44 (2d Cir. 1930). *See also Massey Motors Inc. v. United States*, 364 U.S. 92, 105 (1960) ("there is a risk of error in such projections [of an asset's life and value], but prediction is the very essence of depreciation accounting"). The same difficulty may exist here, and the same result should apply.

D. Whether Customer Relationships Are Sold With Or Without a Going Concern Is Irrelevant

The Third Circuit drew a distinction between the amortizability of a subscriber list acquired *independently* and a subscriber list acquired *with* the purchase of an ongoing concern. Pet. App. 29a. The court reasoned that when a list is acquired independently,

"there [is] no possibility that the value of the list reflected the value of the seller's goodwill." Pet. App. 26a. Even if true, this cannot be the basis for a *per se* rule denying any deduction because of a possibility that the value of the customer relationship bears some relation to the value of the seller's goodwill. This same possibility exists with any other intangible asset that has a relationship to goodwill, such as a patent that was an integral factor developing the goodwill of the seller, but which, as indicated above, is a depreciable asset.

Further, the value of the customer relationships when sold separately do not evaporate when sold as part of a going concern. It simply means that valuing these intangibles may be more complicated, but as long as the burden of doing so is borne by the taxpayer, a deduction is required.

Unlike a newspaper subscription base, the customer relationships of a heating oil company can be and are sold with and without the hard assets of the seller, the name of the seller, its management and its employee base—*i.e.*, the customer base is often sold without any of these elements of the seller's "goodwill." In either case, however, the customer relationships (1) will waste, and (2) will have an ascertainable, measurable value to the purchaser. If the list is sold *with* the going concern, and *if* the concern has substantial goodwill (that exceeds associated costs and liabilities), it is likely the total value will exceed the value of the relationships sold separately, because the goodwill will attract many *new* customers. These are, however, separate from those already acquired and identified. The number, value and life of these new customers is not readily predictable, because they do

not yet exist. They are therefore properly categorized as part of "goodwill" and are nondepreciable. Whatever the additional value of this goodwill, it cannot diminish the value of the existing customer relationships transferred.

E. Any Distinction Between Fixed-Term Contracts and Contracts Terminable-At-Will Is Unsustainable

The rule urged by the Service would create an artificial distinction between fixed-term contracts and contracts that can be terminated at the option of one party. According to the Third Circuit, "the Service does not dispute, that the value of the paid subscribers would not constitute goodwill if Morning Ledger's 'expectation of continued patronage' were contractually-based" because "[i]n such an event, continued patronage would not be a mere 'expectation,' but a contractual right, and hence not goodwill." Pet. App. 11a-12a. This distinction does not reflect the factors that determine useful life or value, as the following examples illustrate.

Take the following three scenarios involving the purchase of a company that makes widgets.

1. In the first scenario, the widget company has 100 fixed-term contracts, with six-year terms, to sell X number of widgets. In this circumstance, it is undisputed that the contracts have an ascertainable value that wastes over a predictable period. An allowance for depreciation of the six-year value of these relationships would be permitted under the Respondent's rationale.

2. In the second scenario, the company has 100 fixed-term contracts with *two*-year terms to sell X number of widgets, but experience has established

that each contract on average will be renewed twice, so that the total expected term of patronage will be *six* years. The purchaser and seller would recognize that the customer relationships have an ascertainable value that wastes—based on experience and other factors—over a six-year period; and the value of the purchase price will take this into account. Under the Service's reasoning, however, the taxpayer could amortize only the value of the asset related to a *two*-year life, and ignore the wasting value of the last four years, even though the *full*, six-year value of the asset would have been reflected in the purchase price.

3. In the third scenario, the company has 100 contracts, terminable at the option of the customer, to provide customers their full requirements of widgets. It can be demonstrated that these contracts will result in the sale of X number of widgets to each customer over a period of *six* years. The purchaser of this company will have included in its purchase price the present value of six years of sales. In this instance, however, the rule suggested by the Service would deny *any* deduction at all, despite the existence of an identifiable wasting asset with an ascertainable value to a purchaser, based on its demonstrable expectations of useful life, that may be identical to the value of the contracts in the first and second scenarios.

Not only is this distinction between fixed-term and terminable contracts incongruent with real world market values, but also it conflicts with the IRS's own regulations. The regulations provide that "useful life" may be established by "experience or other factors." 26 C.F.R. § 1-167(a)-3. The length of a fixed term contract is but *one* "factor" that may be used to

estimate useful life, but it cannot exclude other factors, if there is evidence of others. In many instances the stated term of a contract will not accurately reflect its useful life, or its value to a purchaser, particularly where the contract is renewed in practice. *See, e.g., Business Service Industries, Inc. v. Commissioner*, 55 T.C.M. (P-H) ¶ 86,086 (1986). Experience may also demonstrate that the useful life is less than the asset's inherent period, for example in the common case where a patent is shown to have a useful life less than 17 years.[12] *See, e.g., Sandvik, Inc. v. Commissioner*, 55 T.C.M. (P-H)¶ 86,588 (1986). The IRS regulations make clear that "the estimated useful life of an asset is not necessarily the useful life inherent in the asset but is the period over which the asset may reasonably be expected to be useful to the taxpayer. . . ." 26 C.F.R. §1-167(a)-1(b). These regulations require that the expectations of the taxpayer be considered in the determination of the useful life of the asset.

If a clear demarcation is desired, it should comport with economic reality, as reflected in Petitioner's distinction between its newsstand customers, who may or may not purchase a newspaper on any given day, and are not part of its contractual customer base, and, on the other hand, its subscribers, who purchase a newspaper daily. The paid subscribers have an ascertainable value and predictable useful lives; the newsstand customers, by contrast, do not. Given the statutory language, different tax treatment is appro-

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[12] Actual experience may also lead to an estimate of useful life that is shorter than a contract's fixed term, if in practice the contract is not generally honored for its full term and if enforcement is impractical.

priate for these two different classes of customer relationships.

The same distinction is reflected in a heating oil dealer's customer base. Its automatic delivery customers have a contract with the seller for full requirements over an estimable period. On the other hand, its customers who simply call for a single delivery of heating oil are not part of the heating oil dealer's contractual customer structure. The former have ascertainable values that are paid for by the purchaser, have predictable lives, and hence their value is depreciable.

II. CUSTOMER BASES IN THE HEATING OIL INDUSTRY ARE SEPARATELY VALUED USING THREE ACCEPTED METHODS

A. There Is No Single Appropriate Method of Valuation

Fair market value of an asset is a question of fact. *See, e.g., Delaware, Lackawanna & W. R.R. v. Pennsylvania*, 198 U.S. 341, 358 (1905); *Western Union Tel. Co. v. Taggart*, 163 U.S. 1, 24 (1896); *885 Investment Co. v. Commissioner*, 95 T.C. 156, 167 (1990). It is the price arrived at between willing parties, neither under a compulsion to buy or sell. *See Elmhurst Cemetery Co. v. Commissioner*, 300 U.S. 37, 39 (1937); 26 C.F.R. § 1.170A-1(c)(2); Rev. Rul. 59-60, 1959-1 C.B. 237. Accordingly, no single method of valuation is regarded as determinative of value in all circumstances, and the manner in which an asset is to be valued is a mixed issue of fact and law, but highly dependent upon the business circumstances, a factual matter.[13] *See Commissioner v. McCann*, 146 F.2d 385,

[13] "[T]he question of what criterion should be employed for determining the 'value' of [assets] is a question of law." *Powers v. Commissioner*, 312 U.S. 259, 260 (1941). But specific factual determination of value, properly made within a given "criterion," are matters for the trier of fact. *Commissioner v. McCann*, 146 F.2d 385, 386 (2d Cir. 1944).

386 (2d Cir. 1944); *see also* S. Rep. No. 313, 99th Cong., 2d Sess. 252 (1986). The capitalization of earnings method, *Palmer v. Connecticut Ry. & Lighting Co.*, 311 U.S. 544 (1941), the reproduction cost method, *Los Angeles Gas & Elec. Corp. v. Railroad Comm'n*, 289 U.S. 287 (1933); and the comparable sales method, *Kimball Laundry Co. v. United States*, 338 U.S. 1 (1949) are all acceptable valuation techniques. *See also, Procacci v. Commissioner*, 94 T.C. 397 (1990); S. Rep. No. 313, 99th Cong. 2d Sess. at 252 (legislative history accompanying enactment of 26 U.S.C. § 1060 describing three accepted methods of valuation).

Thus, the best valuation method for Petitioner's customer relationships was a matter for the district court, and the Third Circuit could not reverse this finding peremptorily merely because it would have preferred a different method to value the asset. *Anderson v. City of Bessemer City*, 470 U.S. 564, 573 (1985). The district court's finding as to valuation was not clearly erroneous (Pet. App. 29a) and, thus, should not have been overturned.

B. An Appraiser Must Value the Correct Asset, Which Was Not Done Here By the IRS

In addition, an asset must be properly identified, taking into account all relevant facts, including the asset's projected use. *See Guggenheim v Rasquin*, 312 U.S. 254, 257 (1941). In those instances where an expert improperly identifies the asset to be valued,

the trier of fact may reject this valuation. *See Anselmo v. Commissioner*, 80 T.C. 872 (1983), *aff'd*, 757 F.2d 1208 (11th Cir. 1985); *Jacobson v. Commissioner*, 58 T.C.M. (P-H) ¶ 89,606 at 3061 (1989).[14]

Here, the IRS acknowledges that the customer list has value, but insists on use of a replacement cost methodology as the only method that excludes any element of customer patronage. However, in rejecting the IRS' valuation, the district court determined that the IRS valued the wrong asset for the wrong use (Pet. App. 43a)—*i.e.*, a mere list of names instead of a set of customer relationships that would produce predictable income.[15] Consequently, the district court properly rejected this valuation, not because the replacement cost method is not a reasonable valuation methodology, but because it was used to value a wrongly defined asset.

C. In the Heating Oil Industry, All Three Methods Are Available to Value the Customer Base Separately

The district court adopted the "income method" of valuing the subscriber relationships because it best reflected the method used by buyers and sellers in the newspaper industry to determine price. The replacement cost approach was rejected because there

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[14] In *Anselmo*, for example, the Tax Court was presented with valuations of donated gems. The taxpayer's valuation was rejected because the taxpayer's expert had chosen the wrong market in which the gems should be valued: the retail market, instead of a wholesale market. The IRS' valuation was rejected because the IRS' expert had assumed improperly that the gems were to be valued on a bulk sale basis, as opposed to an individual sale basis. *Anselmo*, 80 T.C. at 886.

[15] "The cost of obtaining [a list of subscribers] does not equate with their value to the enterprise." Pet. App. 43a.

was insufficient evidence to establish the actual cost of reproducing the contractual relationships similar to those purchased. Pet. App. 42a-43a. A comparable sales approach was rejected because of insufficient sales of comparable properties. Pet. App. 42a.

The latter two alternative methods of valuation, although not available to the Petitioner, are generally applicable to sales of heating oil customer bases. A replacement cost approach can fairly estimate the level of expenditures required to add new automatic delivery customers to an existing heating oil business. (Heating oil dealers regularly engage in marketing activities to attract new contractual customers.)

In addition, the comparable sales method can be used. Because of the abundance of small companies in this industry, there are many sales of customer relationships and comparable values are often available. Moreover, because heating oil customer bases are often sold without the sellers' name, employees and management, the comparable sales method can value the customer base separately, even in a transaction that includes the transfer of the seller's name, by reference to comparable prices in transactions that do not include the seller's name. Consequently, a comparable sales method can also establish the value of the customer base separate from goodwill.

It is not necessary that all three methods be available. Any method that produces a reasonable estimate of fair market value should be acceptable. *See* cases cited *supra* at 20-21. If the income method is the most appropriate, and is used by the parties to establish market price, as it was here, it should be available to the trier of fact.

The experience of the heating oil industry demonstrates that customer relationships have a value separate from any element of goodwill. Any *per se* rule that equates such customer relationships with nonamortizable goodwill would force courts to ignore the statute and evidence that an asset is wasting and has ascertainable value. It would impose a rule of law that this demonstrable value disappears into the "goodwill" of an enterprise. This result is in conflict with market reality and the plain requirements of the Code.

CONCLUSION

The judgment of the court of appeals should be reversed.

Respectfully submitted,

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June 5, 1992